$50.00 ANNUALLY
40 Letters Per Year

DOW THEORY LETTERS

"The Market as Interpreted under the Dow Theory"

RICHARD RUSSELL
P. O. Box 15196
San Diego 15, California

Registered with the Securities and Exchange Commission

October 5, 1961 Number 158

THE MARKET Letter 157 drew attention to the outstanding performance of the Rails. As of this writing, Rails continue to be the strength of the market. On the decline to W (691.86), Industrials sank to their lowest level since July (K). It is notable, however, that during the same decline (see chart), Rails held 14¢ above T and better than 2 points above M (139.44). Following the establishment of the lows at W, volume contracted sharply, and this had bullish implications.

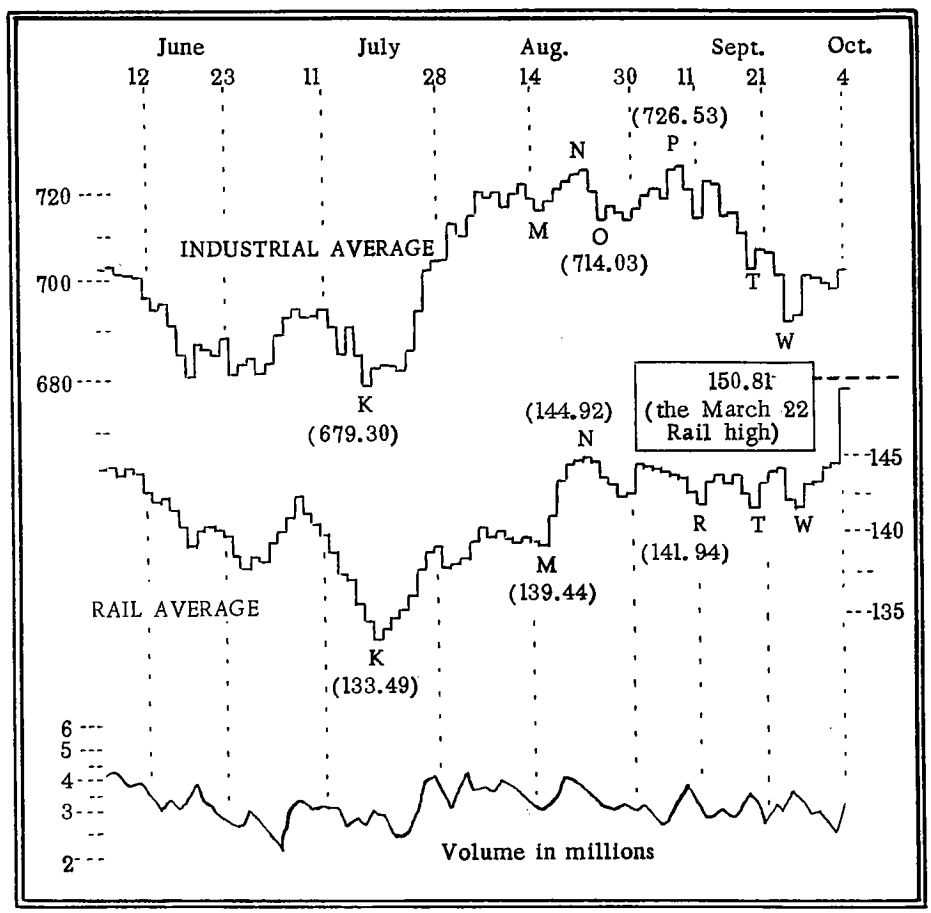
Letter 157 also stated: "A persistent refusal by Rails to penetrate M will call for at least a minor upward reversal." Between September 28 and October 3, Rails rose on four consecutive days while Industrials sank lower (but still held above W). Consistent divergence in the two Averages often prefaces violent movements. On October 4 both Averages surged to the upside (thus Rails lead the market higher in the first "in gear" movement since September 27). As of this writing (October 4), Rails have broken above their long "line" formation (which has been in effect since mid-August). The authenticity of the advance will now be gauged by the ability or inability of the Industrial Average, the advance-decline ratio and the new-high index to follow the leadership of the Rails.

Conclusion: Rails have now bettered their August peak at N (144.92). If Industrials can confirm by bettering P (726.53), the secondary trend will have turned bullish again. It should be remembered however, that a high on one Average, not confirmed by a high on the other, is meaningless -- and more often than not deceptive.

The secondary trend is bearish, but will be bullish if Industrials better P. The primary trend or great tidal force of the market remains bullish.

AN IMPRESSIVE PERFORMANCE In March and April, 1961, the "new high" index hit its peak and turned down. In May the advance-decline ratio "topped" and turned down. Over the last few weeks international news reached crisis proportions on several occasions (Berlin, resumption of nuclear testing and Mr. Hammarskjold's death). The public (as represented by odd-lot sales and short sales) has turned cautious to bearish. A great many stocks have sustained severe declines and even collapses since the first quarter. The stocks on the American Exchange (see Letter 155) have been in a declining trend for many months.

In the face of all this, the D-J Industrial and Rail Averages have (so far) refused to "break away" on the downside. The stocks in the D-J Averages tend to be investment-grade issues as opposed to the mass of stocks which are listed on both Exchanges. More than any other group (and this represents their greatest usefulness), the movements of the stocks in the D-J Averages represent the buying and selling proclivities of "informed investors".



In bull markets either the Averages or "breadth" (the advance-decline ratio) will lead an advance, but sooner or later both the Averages and the great mass of stocks must get "in gear" on the upside. By the same token, in a bear market either breadth or the Averages will lead a decline, but sooner or later both indicators must go down or it is not a bear market.

The advance-decline ratio has been leading the way down since May of this year. As yet, the Averages have not confirmed. In the face of a great deal of bearishness, the D-J Averages have (so far) held persistently above the July lows and this must be taken as an impressive performance. A continued refusal by the Averages to penetrate the July lows will call for an important upward reversal. Based on past history, if breadth cannot lead the Averages down, then the Averages will lead breadth up. This is the situation which prevails at this time. The longer one or both Averages hold above the July lows, the more the odds favor a broad reversal in the opposite direction.

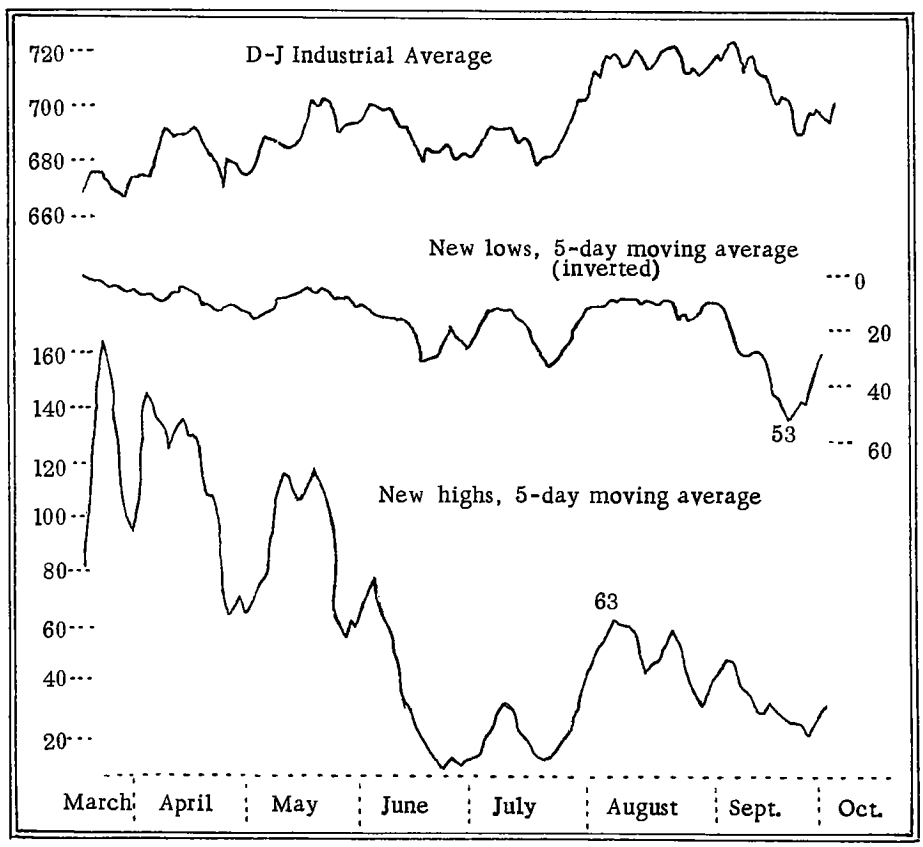
A FURTHER TEST OF MARKET STRENGTH In Letter 146 (and again in Letter 148) attention was directed to the poor showing of the daily index of new highs and lows. This indicator, when properly used, can be an excellent gauge of underlying market strength or weakness. I prefer to use the high-low index as a confirmatory tool in conjunction with the advance-decline ratio. (The chart presents daily new highs and lows in the form of a sensitive but smoothed-out 5-day moving average).

In a truly strong market, the majority of stocks are advancing and an increasing number of issues are lending momentum to the advance by "breaking out" of their established price patterns and rising to new highs. Other stocks that have already recorded new highs are continuing their climbs.

From April through September, 1961, the Industrial Average advanced to three successive all-time highs. As pointed out in previous Letters, however, the advance-decline ratio (representitive of all the stocks on the Exchange) reached its peak in May. Furthermore, the accompanying new high-low chart shows that the new high index established its peak in March and April. This was one of the earliest hints of trouble ahead.

Note that at the same time the new high index was "topping" (March-April), the new low index (inverted) was steadily expanding. For this reason, even the May peak on the advance-decline ratio was suspect.

During the June- July market decline, new highs contracted sharply (which is normal), while new lows expanded to an average of 32 (see Letter 148). The "test" came in August-September when the Industrial Average rallied to another all-time high. On August 8 the new high index touched its best level of the entire rally at 63 (less than half the number previously seen in March and April). This was a poor performance and merely confirmed the sagging performance of the advance-decline ratio.



Most recently, on September 25, new lows expanded to 53. This was the largest 5-day average of new lows since December, 1960.

During market advances the new high index may best be compared with its own preceding peak levels. For this reason, the first sign of real underlying strength on any forthcoming rally would be an expansion of new highs (5-day average) above the 63 recorded on August 8. During declines the same procedure may be followed. Increased market weakness will be recognized if the number of new lows (5-day average) expands beyond the September 25 level of 53.

TIME CHANGE There are an estimated twelve to fifteen million stockholders in the country today. It is my opinion that over an extended period of time, the great majority of these "investors" will show losses for their time and trouble. This is not meant as sarcasm or even as a warning; it is simply a testament to the toughest

business in the world. "Why is Wall Street so difficult?" rightfully asks the neophyte. The answer is that the market is constantly "playing" on our emotions. That this is true is documented by the history of the odd-lot or "little fellow's" reactions to market trends. The odd-lotter buys and sells according to (1) what he reads in the newspapers, and (2) the way he "feels" about stocks and the economy. Unfortunately, the large investor (being wiser) uses the public's emotions for his own purposes.

For instance, when times are bad , when the economy is in recession, and when everything suggests to the little fellow that he is going to lose money in the stock market, the large investor knows that he should begin accumulating stocks. Dow understood this when he wrote: "When the market is down and dull, it is hard to make people believe that this is the prelude to a period of activity and advance. When prices are up and the country is prosperous, it is always said that while preceding booms have not lasted, there are circumstances connected with this one which make it unlike its predecessors and give assurance of permanency. The one fact pertaining to all conditions is that they will change."

In other words, the experienced investor knows that what goes down goes up, and what is up eventually does down. The large investor has money and patience, and he does not have to enter or leave the market unless conditions are to his liking. The big investor is not trying to make a weekly "killing", and he usually possesses (as Dow put it) "patience enough for six men".

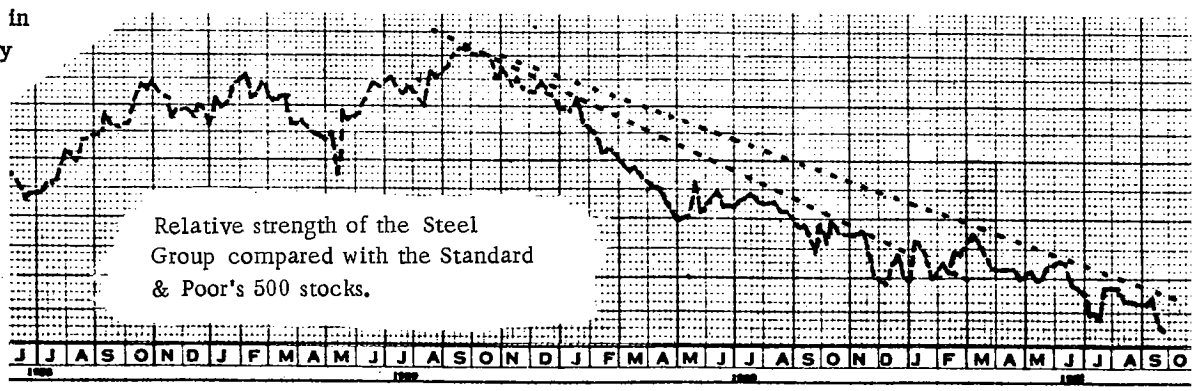
There is a basic change in conditions today (other than high taxes and brokerage commissions) which militates against profits in the stock market. This is the Federal Government's attempt to sustain everlasting prosperity by ever-increasing spending. This program has had the effect of greatly extending the primary movements. As prosperity continues, people lose all fear of the market, and they are willing to bid prices up to unprecedented heights while disregarding low or non-existent yields. Because the primary movements have been so great over the last decade, it is certainly probable that the next bear market will be longer and more drastic than might otherwise have been the case.

Because of the extension of the primary movements, experienced investors find that their patience is often sorely tried. In "the old days", bull markets generally lasted a year to a few years, bear markets perhaps half as long. Consequently there was an excellent chance to ride the primary trend up or down every year or so. The long, often tedious primary movements since 1949 have been abnormal (judged in the light of history), and in many ways they have presented fewer opportunities for intelligent trading profits than did the swings of earlier days.

GROUP RELATIVE STRENGTH One of the most fascinating aspects of price movements is the relative strength of various stock groups. The charts below plot the action of a few major stock groups as compared with (or as a ratio of) the price of the broad Standard & Poor's 500 Stock Average (which is representitive of the entire market).

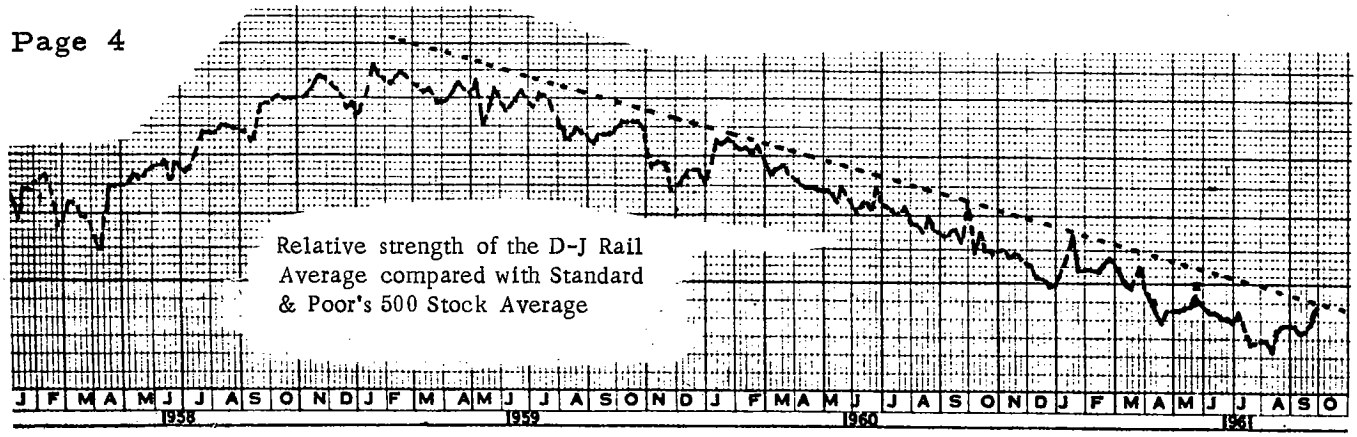
One of the peculiarities of group relative strength is that it tends to hold to long trendlines. Regardless, of rallies or declines in a given group, it is seldom that a group's relative strength will change trend more than two or three times in a year. One of the best ways of detecting accumulation or distribution is through group relative strength studies. For instances, the actual average price of ten steel stock may be rising, but if it is rising slower than the general market then the relative strength of the steel group is behind the market. Consequently, the relative strength line on the steel group will decline. Such relative strength declines in rising markets often implies distribution. The converse is true of accumulation.

The chart below shows the long downward trend in relative strength (R. S.) in the steel group during 1959 and 1960. During January and February of 1961 the steel group's R. S. turned up, but most recently steel's R. S. has weakened again. Last week the R. S. on Steels dropped to its lowest point in recent years. Obviously this does not auger well for steel stocks.



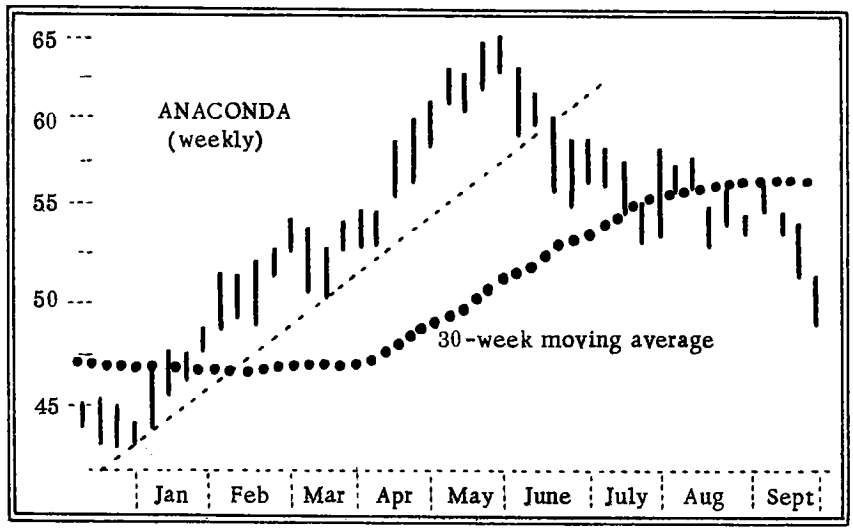
Relative strength of the Steel Group compared with the Standard & Poor's 500 stocks.

The chart on Rail R. S. is most interesting. Since January, 1959, Rail R. S. has been going steadily down. But the recent action of the

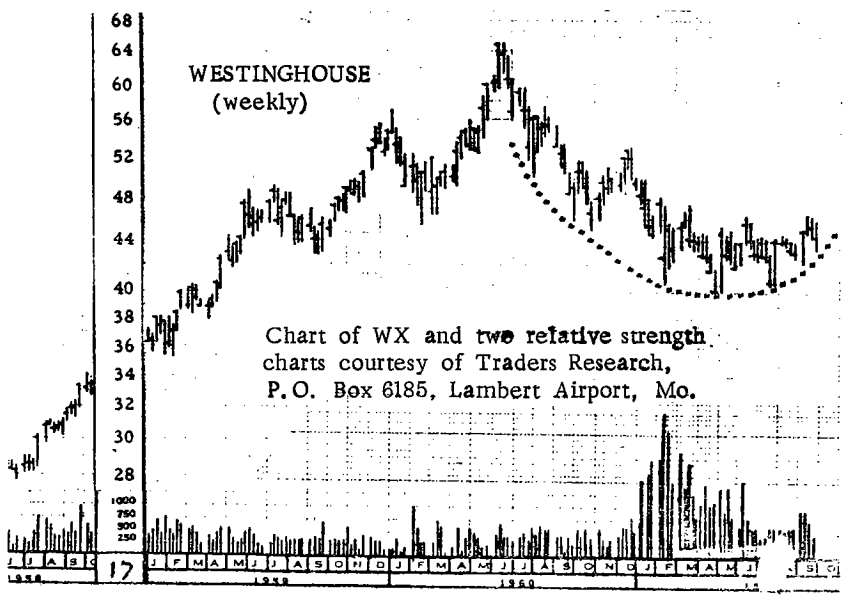

Relative strength of the D-J Rail Average compared with Standard & Poor's 500 Stock Average
J F M A M J J A S O N D J F M A M J J A S O N D J F M A M J J A S O N D J F M A M J J A S O
1958
1959
1960
1961

Rails has taken their group R. S. up to the trendline. An upward penetration of this long descending trendline could be the signal for a concerted Rail move. In that case, Rails might be one of the most profitable groups on the Exchange.

STOCKS Eight of the seventeen stocks in our "continuing study group" are now above their long-term or 30-week moving average. This is no change from last week.



Anaconda, traditionally a wide swinger, provides a good test of trading with a long-term moving average. In early February Anaconda (A) rose above its moving average (M. A.) which at that time was 47. Alowing 5% for a clean upward penetration, A would have been bought at about 49 1/2. The stock rose in a straight-line trend to a high of 65. The first sign of danger, following the precipitous rise, was a breaking of the ascending trendline (dotted line). Had the stock been sold on a trendline penetration it would have been sold at about 57 1/2 for an eight point profit (before commissions). If the trader had waited for a clear (5%) downside penetration of the M. A. he would have sold A in September at about 55, netting a profit of about 5 1/2 points after commissions. While this is admittedly no earth-shaking performance, it at least represents a profits in a very difficult, "whip-sawing" market. As a rule, following a straight-up move such as that witnessed in A following the February penetration of the M. A., I would rather sell on a violation of an important trendline , rather than wait for a possible downward penetration of the M. A. A is now clearly bearish, holding well below its current M. A. of 56 3/8.



International Harvestor broke below its M. A. (now 52 1/2). I list the stock as bearish. American Telephone has been looking weak for many weeks (see Letter 152), and I would switch holding to Westinghouse. (M. A. on Telephone now 121). Sears Roebuck continues in the bullish trend which began in December, 1960. On October 4, the stock rose to an all-time high (M. A. is 65 5/8). U. S. Steel broke below its M. A. (now 85 1/8), and I would prefer not to hold the stock. A break to the 78 area would mean that Steel had turned definitely bearish.

The weekly chart of Westinghouse shows the great 1958-60 advance and the resultant 1960-61 collapse. During 1961 a great "rounding bottom" has formed, and such patterns suggest gradual accumulation. WX can be bought at the market with a minimum of downside risk. A rise above 48 could set off an important advance.

This Letter written Wednesday, October 4, after the close of the market.